Agenda Item No.____________

File Code No. 240.03

CITY OF SANTA BARBARA
SANTA BARBARA FINANCING AUTHORITY

AGENDA REPORT

AGENDA DATE: December 23, 2008

TO: Mayor and Councilmembers
Board of Directors, Santa Barbara Financing Authority

FROM: Administration Division, Finance Department
Administration Division, Airport Department
City Attorney's Office

SUBJECT: Airport Terminal Project Bond Issuance

RECOMMENDATION: That Council and Board Members:

A. Adopt, by reading of title only, A Resolution of the Board of Directors of the Santa Barbara Financing Authority Authorizing the Issuance of Not to Exceed $65,000,000 of Santa Barbara Financing Authority Lease Revenue Bonds (Airport Project), Series 2009, Approving the Execution and Delivery of Various Related Documents in Connection with the Offering and Sale of Such Bonds and Other Matters Related Thereto; provided, however, that with respect to the Series 2009A Bonds, the true interest cost shall not exceed 8.0% per annum, and that with respect to the Series 2009B Bonds, the true interest cost shall not exceed 9.0% per annum;

B. Adopt, by reading of title only, A Resolution of the City Council of the City of Santa Barbara Approving the Issuance by the Santa Barbara Financing Authority, in One or More Series, of Not to Exceed $65,000,000 of Santa Barbara Financing Authority Lease Revenue Bonds (Airport Project), Series 2009, Approving the Execution and Delivery of Various Related Documents in Connection with the Offering and Sale of Such Bonds and Other Matters Related Thereto; provided, however, that with respect to the Series 2009A Bonds, the true interest cost shall not exceed 8.0% per annum, and that with respect to the Series 2009B Bonds, the true interest cost shall not exceed 9.0% per annum;

C. Approve and authorize the Airport Director to execute, subject to City Attorney review of the form of the agreement, an Amendment to Contract 22,644 with Jacob Consultancy, for the preparation of the Report of the Airport Consultant, Airport Feasibility Report, on the proposed issuance of debt for the Airline Terminal Improvement Project, increasing the contract by $99,000 for a total not–to-exceed amount of $225,000;

D. Authorize the City Attorney to execute an agreement with Orrick, Herrington & Sutcliff, LLP, for Bond Counsel services in the amount of $62,500 and Disclosure Counsel services in the amount of $35,000, together with reimbursed expenses not to exceed $5,000, for the Airport Revenue Bond Financing payable from bond proceeds at such time as the bonds are issued;

E. Approve and authorize the Finance Director to execute, subject to City Attorney review of the form of the agreement, an agreement with KNN Public Finance for financial advisory services for the Airport Revenue Bond Financing in an amount not to exceed $115,000, together with reimbursed expenses not to exceed $5,000, payable from bond proceeds at such time as the bonds are issued; and

F. Authorize the Airport Director to execute, in a form acceptable to the City Attorney, an amendment to the Airport Promissory Note dated July 1, 2008, in the amount of $7,800,000 to extend the maturity date of said promissory note to June 30, 2009.

EXECUTIVE SUMMARY:

After many years of planning and development, the construction of Airport Terminal Project is nearing fruition. At a total estimated cost of almost $73.5 million, it is one of the largest capital projects, if not the largest, ever undertaken by the City. Attachment 1 summarizes the sources and uses of funds for the project. Funding sources include Federal Aviation Administration grants ($16.2 million), Passenger Facility Charge revenue ($4.9 million), Customer Facility Charges on rental car contracts ($800,000), Airport Department funds ($6 million) and lease revenue bond proceeds ($45.5 million).

Staff has made numerous presentations to the Finance Committee and City Council on this project and the proposed bond issue, including presentations from members of the City's financing and consulting team. The Airport Commission has also received presentations on both the project and the financing.

The recommendations in this agenda report, if approved by Council, will authorize the City Administrator and staff, without further Council action, to proceed with the bond issuance. Unfortunately, the issuance of the Airport bonds is significantly complicated or even precluded at the present time by the unfavorable and extremely volatile credit markets. Current estimates are that the interest rate on the Airport bonds could be as high as 8%, assuming they could be sold at all. Despite this, staff recommends that Council authorize the issuance so that we will be in a position to sell the bonds when the credit markets become more available and more reasonably priced. Staff, in consultation with its financial advisors, has reason to believe that this might happen sometime in the first sixty days of the next year. By having the authorizations in place, the City Administrator and staff will be able to respond quickly to any favorable changes in the credit market. As provided in Recommendations A and B above, the Council's authorization to the City Administrator and staff is limited to issuance of the Series 2009A Bonds with a true interest rate of not to exceed 8% per annum and limited to issuance of the 2009B Bonds with a true interest rate of not to exceed 9% per annum.

The negative news in the credit markets is substantially offset by extremely good news on the project cost. On Tuesday, December 16, 2008, bids were opened for the main terminal project construction contract. As we hoped would be the case given the recessionary environment, the City received extremely favorable bids. The apparent low bid is $32.5 million. This is almost 29% below the engineers' estimate of $45.6 million. The second low bid is $34.9 million. It would be extremely unfortunate if we are not able to take advantage of bids this favorable due to the lack of available tax-exempt financing.

The balance of this report will describe the overall structure of the financing, the financing team, the documents before the Council for approval and some of the considerations that staff will use in deciding whether and when credit market conditions warrant issuance of the bonds.

DISCUSSION:

The Financing

The net amount of the bond issuance is expected to be approximately $57.7 million. Along with approximately $1.8 million of Airport funds, the proceeds will be allocated approximately as follows:

(in millions)	
Project Funds	$ 44.80
Debt Service Reserve Fund	5.10
Capitalized Interest	8.60
Costs of Issuance	0.50
Underwriters Discount	0.50
Total Bond Amount	$ 59.50

It should be noted that the documents before Council today authorize a bond issuance in an amount not to exceed $65 million. This is considerably higher than the actual anticipated "par" amount of the bonds of approximately $60 million. It is standard practice to authorize issuance of an amount higher than anticipated just as it is standard practice to authorize a maximum interest rate higher than we would expect or even be willing to pay. Setting the not to exceed amounts for both size and interest rate in this manner allows for maximum flexibility in reacting and adjusting to market conditions.

The bonds will be issued by the Santa Barbara Financing Authority (SBFA). The SBFA was created in 2002 as a joint powers authority between the City and the Redevelopment Agency to facilitate the issuance of City bonds such as these Airport bonds.

As explained in detail in Attachment 2, the proposed financing involves the issuance of two series of bonds by the SBFA. Interest on the Series 2009A bonds will be tax-exempt (though subject to the federal Alternative Minimum Tax, if applicable). This series will be approximately $50 million and will finance the new airline terminal and the associated improvements to roadways, parking, "airside" improvements and utilities. The Series

2009B bonds will be taxable (i.e. the interest component must be reported as "income" for tax purposes) and will finance the joint-use rental car facility. The Series B bonds are taxable because the facility being financed will be used by for-profit businesses. The City will ground lease the Airline terminal to the SBFA pursuant to a Site Lease and the City will lease the terminal back from the SBFA pursuant to a Facilities Lease. The Facilities Lease will obligate the City to construct the new terminal, rental car facilities and other facilities. As previously explained to the Finance Committee and City Council, the annual bond payments will be an obligation of the City's General Fund but the source of repayment will be Airport Funds. The leases create a rental obligation that is officially an obligation of the City's General Fund but will be reduced to the extent payments are made from Airport Funds. Staff, along with Jacobs Consultancy, has carefully evaluated Santa Barbara Airport revenue streams as well as industry trends and projections to ensure that Airport revenues will be sufficient to pay the debt service on the bonds. The bonds will have a 30-year term.

The Documents

By adoption of the two resolutions accompanying this report, the City Council and SBFA Board of Directors are approving and authorizing the City Administrator and City Attorney to execute and/or issue the following documents:

- A Trust Agreement between the SBFA and The Bank of New York Mellon Trust Company, under which the bank contracts to represent bond holders. Debt service payments are sent by the City to the trustee bank which is then responsible for relaying the funds to the bond holders.

- A Site Lease, as described above, between the City and the SBFA under which the City will ground lease the Airport terminal property to the SBFA.

- A Facility Lease, also as described above, under which the City will lease the property back from the SBFA with an obligation to construct the new terminal, rental car facilities and other facilities. Under the Facility Lease, the City will be obligated to make base rental payments to the SBFA in an amount equal to the debt service on the bonds, which the SBFA will then use to pay debt service on the Series 2009 Bonds.

- An Installment Payment Contract between the City and the SBFA pursuant to which the City will be obligated to make installment payments to the SBFA which the SBFA will use to pay debt service on the Series 2009 Bonds

- A Preliminary Official Statement (POS) which is a public disclosure document that investors can use to assess the City's Airport bond issue. The POS contains important disclosure information about the City, the Airport, the bond issue, and the project.

- A Purchase Contract between the City, SBFA and the underwriter, Morgan Stanley, being contracted with to sell the bonds and in which the underwriter agrees to purchase and market the bonds.

- A Continuing Disclosure Agreement between the City and the Trustee which requires on-going financial disclosure by the City.

The Financing Team

The City has retained a team of professionals to facilitate the issuance of the bonds. The law firm of Orrick, Herrington & Sutcliffe, LLP ("Orrick") has been retained as bond and disclosure counsel. The primary role of bond counsel is to issue an opinion on the tax status of the interest earned by investors on the City's bonds. In addition, bond counsel ensures that the City follows and meets all applicable federal and state laws and regulations in the issuance of the bonds. As disclosure counsel, Orrick works with the City to ensure that the City complies with all legal obligations to disclose to investors all pertinent and relevant facts regarding the bond deal and the City's finances that might have a material effect on an investor's decision to buy the bonds. Recommendation D of this agenda report authorizes the City Attorney to execute an agreement with Orrick for these services in an amount not to exceed $97,500 plus expenses not to exceed an additional $5,000. Orrick's compensation will be paid from bond proceeds if and when the bonds are sold.

The firm of KNN Public Finance has been retained as the City's financial advisor. As financial advisor, KNN's role is to represent the City and ensure that the structure, pricing and marketing of the bonds is in the City's best interests. Recommendation E of this agenda report authorizes the Finance Director to execute an agreement with KNN for financial advisory services in an amount not to exceed $115,000 plus expenses not to exceed an additional $5,000. KNN will be paid from bond proceeds if and when the bonds are sold.

The firm of Jacobs Consultancy (Jacobs) is an airport consulting firm that has provided consulting services to the Airport for some time on matters such as airline rates and charges, Passenger Facility Charge applications and capital planning. Jacobs was selected after a competitive request for proposal process to be part of the financial team. Jacobs' role is to prepare an Airport Feasibility Report which provides investors with information and analysis on the Airport's finances and operating data and demonstrates the ability of the Airport to meet the debt service obligations. Jacobs has also assisted the Airport in negotiations and discussions with the airlines regarding the Terminal Project and the projected fiscal impacts of the project on their rates and charges. Recommendation C of this report will authorize a $99,000 increase to the City's agreement with Jacobs to a total amount of $225,000. The increase in the contract is specifically to pay for the cost of the Airport Feasibility Report which is a critical component of the bond documentation.

The firm of Morgan Stanley ("Morgan") is being contracted with to act as the underwriter to sell the bonds. Morgan's compensation will be negotiated at the time of the bond sale and will be paid from bond proceeds. The bond documents before City Council establish a maximum compensation for Morgan of 1.25% of the bond amount.

The Promissory Note

In July 2008, the City Council approved the issuance of a $7.8 million Airport promissory note which the City purchased as an investment. The proceeds of the promissory note allowed the Airport to begin construction of the joint use rental car facility prior to issuance of the Airport bonds. This was necessary because the existing rental car facility would have to be demolished prior to beginning construction of the Terminal Project. It was therefore necessary to construct the replacement rental car facility before the Terminal Project began. Construction of the new rental car facility is now well underway. The Promissory Note will be repaid from the proceeds of the Airport bond issue. Originally, when approved by Council, it was anticipated that the bond proceeds would be available to repay the Promissory Note by January 1, 2009. The maturity date on the Note was set at January 1, 2009. The bond issuance, however, has been delayed because of market conditions and other factors and proceeds will not be available by January 1, 2009. As a result, it is necessary to extend the maturity of the Promissory Note. Recommendation F will authorize an amendment to the Promissory Note extending the maturity to June 30, 2009. All other terms and conditions of the Note, including the 6.5% interest rate, remain the same.

Summary and Considerations

The ability of the City to issue the Airport bonds is adversely impacted by the current state of the credit market. As stated earlier in this report, given the current state of the credit markets, it is unlikely that the bonds could be sold at this time. Further, even if the bonds could be sold, the interest rate would likely be as high as 7.75% to 8%. Although the bond documents before Council establish a not to exceed interest rate of 8% on the tax-exempt Series A bonds and 9% on the taxable (rental car) Series B bonds, staff considers these to be unacceptably high interest rates and will not proceed with issuance at these levels. The hope is that the credit markets will recover enough in the first 60 days of 2009 to allow us to proceed with issuance at a more reasonable interest rate of around 7% for the tax-exempt piece.

The equation is, however, clearly affected by the extremely favorable bids that the City received on December 16th. Lower bids mean a smaller bond size which, of course, translates into lower debt service. In the end, staff believes the proper decision-making criterion is reaching an acceptable annual debt service amount which is a function of both the bond size and the interest rate. A smaller bond issue (due to the favorable bids) may permit the City to accept a higher interest rate still resulting in an acceptable annual debt service amount. Staff has already begun working with the financing team to assess the impact of the lower than expected bids on the financing plan. The construction bids are valid for 90 days from the December 16th bid opening and can be accepted by the City anytime during that period. It is certainly hoped that the financing can be secured within that time frame so we can take advantage of the favorable bids.

There is another potential factor which could favorably affect the Airport bond issue. Generally, the interest paid on municipal bonds is tax-exempt. This means that the interest the bond holders earn on the Airport bonds are exempt from state (California) and federal income tax. Because investors do not pay income taxes on the interest they earn on the bonds, they are willing to accept a lower interest rate than they would on taxable corporate bonds. However, under current federal tax law, while municipal airport bonds, such as the City's Terminal Project Bonds (the Series A bonds) are tax-exempt bonds, because they are used to construct a facility that, while public, serves the needs of a commercial activity (airlines), the interest earned on the bonds is subject to the federal Alternative Minimum Tax (AMT). These types of tax-exempt bonds are known as "AMT Bonds." Because most of the individual investors who purchase municipal bonds are high net worth (high income) individuals, they are all usually also subject to the AMT. Interest they earn on the bonds is, therefore, essentially taxable. In order to reflect this AMT taxation, the interest rates on AMT bonds are higher than on non-AMT tax-exempt bonds. In the current bond market, the interest rate on AMT bonds can be as much as a full 1% higher than non-AMT bonds. Recently, in response to the severe economic downturn, Representative Richard Neal (D-Mass), a member of the House Ways and Means Committee has introduced a bill that would exempt certain municipal bonds, including airport bonds, from the AMT provision. The Committee chairman, Max Baucus (D-Mont), said last week that he was considering legislation to exempt all municipal bonds used for infrastructure from the AMT as part of the upcoming economic stimulus legislation. If this legislation passes, it would immediately reduce the interest rate on our Airport bonds by as much as a full 1%. Staff will watch the progress of the legislation and will certainly delay issuing the Airport Bonds if it appears likely that such legislation will pass and soon become law.

It is essential that Council understand that approving the recommendations in this agenda report will authorize the City Administrator and staff to proceed with the bond issuance without any further Council action. The authority given the City Administrator, however, does not allow the City Administrator to issue the bonds unless the per annum interest rate on the tax exempt bonds is 8% or less and 9% or less on the taxable bonds. Staff will proceed with extreme caution and will certainly keep the Council informed by memo or email on the feasibility and timing for issuing the bonds. This is especially important given the state of the credit markets, the interest level and the possibility of federal legislation.

The Airport Terminal Project has been under development for years and staff has almost reached the point of beginning construction. If the tax exempt bond market cooperates, the City will be able to begin construction on this critical and long-awaited infrastructure project.

The documents listed below have been separately delivered to the City Council and are available for public review in the City Clerk's Office and the Finance Department.

1. Trust Agreement
2. Site Lease
3. Facility Lease
4. Installment Payment Contract
5. Preliminary Official Statement (POS)
6. Purchase Contract
7. Continuing Disclosure Agreement

ATTACHMENTS:

1. Sources and Uses of Funds
2. Structure of the City's Airport +Lease Revenue Bond Financing

SUBMITTED BY: Robert D. Peirson, Finance Director
Sarah J. Knecht, Assistant City Attorney

APPROVED BY: City Administrator's Office

Sources and Uses

- Three major projects will require debt financing
  - Terminal renovation and expansion project
  - Rental car facility
  - Sewer improvements
- Debt will be secured by three sources of funds prior to General Fund
  - Passenger Facility Charges (PFCs)
  - Customer Facility Charges on car rentals (CFCs)
  - General airport revenues

Uses of Funds	
New Terminal	$45,000,000
Roadways	$2,000,000
Parking	$3,900,000
Airside	$7,900,000
Paving	$1,200,000
Total Anticipated Terminal Cost	$60,000,000
Rental Car Facility	$7,800,000
Sewer System	$4,360,000
Miscellaneous	$1,311,000
Total Uses of Funds	$73,471,000

Sources of Funds	
Federal	$16,207,000
Department Funds	$6,048,000
Passenger Facilities Charges	$4,944,000
Customer Facility Charges	$800,000
Bonds proceeds	$45,472,000
Total Sources of Funds	$73,471,000

Attachment 1

Structure of the City's Airport a Lease Revenue Bond Financing

The proposed financing of the City's new Airport Terminal and rental car facilities. involves the issuance of two series of bonds by the Santa Barbara Finance Authority. The Santa Barbara Finance Authority is a joint powers authority ("JPA") consisting of the City and the Redevelopment Agency which is governed by the Council and the Agency Board. It was formed in 2002 pursuant to state Government Code authority which provides for the formation of a JPA, in particular for the purposes of issuing tax-exempt debt instruments. The interest on one series will be tax exempt (though subject to the alternative minimum tax, if applicable) and will finance the Airport Terminal and the interest on the other series will be taxable and will finance the rental car facilities. Attached is a summary diagram of the proposed structure.

The City will ground lease the Airport Terminal site to the Authority pursuant to the Site Lease and lease it back from the Authority pursuant to the Facilities Lease with an obligation to construct the renovated terminal, the rental car facility and other facilities. This will create a City rental obligation to make principal and interest payments to the Authority (which the Authority will assign to the trustee) on the bonds. While this rental obligation is payable from the City's General Fund, it will be reduced to the extent that the City makes Installment Payment Contract payments from Airport Revenues. City staff, along with the City's financial analyst and airport revenue consultant, believes that there will always be more than a sufficient amount of Airport Revenues to pay debt service. (See debt service coverage projections.) Assuming the bonds are issued in the aggregate principal amount of $59,970,000, and are structured with level debt service, and assuming a blended true interest cost of 7.60%, annual debt service would be approximately $5,075,000. Assuming debt service on the bonds escalates at approximately 2% per year, the principal amount of $61,330,000, would have a blended true interest cost of 7.71%. The annual debt service would range from approximately $2,482,818 in 2009 to $7,301,500 in 2038.

The City and/or the Authority will approve the following documents in order to accomplish this financing:

(a) the Trust Agreement (between the Authority and The Bank of New York Mellon Trust Company, as trustee), pursuant to which the Authority issues the two series of bonds;

(b) the Site Lease (between the City and the Authority), pursuant to which the City leases the Airport Terminal site to the Authority;

(c) the Facility Lease (between the City and the Authority), pursuant to which the City leases back the Airport Terminal site from the Authority;

(d) the Preliminary Official Statement, which is the disclosure document the Underwriter uses to sell the bonds;

(e) the Purchase Contract (between the City, the Authority and Morgan Stanley, as Underwriter), which provides for the sale of the bonds to the Underwriter;

(f) the Installment Payment Contract (between the City and the Authority), which provides for the pledge of Airport Revenues to pay debt service on the bonds; and

(g) the Continuing Disclosure Agreement (between the City and the Trustee, as Dissemination Agent), which requires on-going financial disclosure by the City.

While Section 1210 of the City's Charter requires an election for the City to issue revenue bonds, the Santa Barbara Finance Authority is regulated by the state Government Code and is not governed by the Charter or Municipal Code and may issue bonds without an election under relevant provisions of state law. The Authority will issue bonds pursuant to the Trust Agreement which will be sold to the Underwriter pursuant to the Purchase Contract. The proceeds of the sale of the bonds will be deposited with the Trustee and used by the City to construct the two facilities through requisitions by the City.

BASIC STRUCTURE OF
LEASE REVENUE BONDS FINANCING